

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 AID-05 EB-07 MC-02 ACDA-05 CIAE-00

DODE-00 PM-04 H-02 INR-07 L-03 NSAE-00 NSC-05 PA-01

PRS-01 SP-02 SS-15 USIA-06 IO-10 TRSE-00 OMB-01 SAM-01

SAB-01 IGA-01 /090 W

----- 022184

R 051456Z NOV 75

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 8860

INFO AMCONSUL JERUSALEM

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E.O. 11652: NA

TAGS: EAID, EFIN, IS

SUBJ: ISRAEL'S ECONOMIC ANXIETY

REF: A) TEL AVIV 6959; B) TEL AVIV 6847; C) TEL AVIV A-173
SEPT 26,1975

1. SUMMARY: CONCERN ABOUT ISRAEL'S ECONOMIC SITUATION IS GROWING. GOI IS ITSELF RESPONSIBLE FOR SOME OF INCREASED ANXIETY BECAUSE OF ITS COMMITMENT TO CONTINUED DEVALUATIONS AND CRACK-DOWN ON TAX EVASION. ISRAELI CONSUMER'S REACTION IS TO BUY NOW AND PAY LATER. GOVERNMENT APPARENTLY HAS NO CHOICE BUT TO TIGHTEN SCREWS FURTHER. END SUMMARY.

2. ANXIETY ABOUT ISRAEL'S ECONOMIC SITUATION, NEVER LOW, HAS RECENTLY REACHED NEW HEIGHTS. RUMORS ARE RIFE OF A VARIETY OF IMPENDING CALAMITIES RANGING FROM THE PROBABLE--FURTHER DEVALUATION AND NEW AUSTERITY MEASURES, TO THE POSSIBLE BUT UNLIKELY--TAXATION OF INDEX-LINKED BONDS, OR EVEN ESTABLISHMENT OF A NEW CURRENCY UNIT CALLED THE SHEKEL. UNDER THIS LATTER SCHEME, ALL EXISTING CURRENCY WOULD HAVE TO BE EXCHANGED FOR THE BRAND NEW
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SHEKEL, PERHAPS AT A DISCOUNT OF TEN PERCENT. ALTHOUGH OLD-

TIMERS RECALL THAT SUCH A SCHEME WAS USED WHEN THE ISRAELI POUND WAS INTRODUCED IN THE EARLY 1950'S, BANKERS AND ECONOMISTS IN AND OUT OF THE GOVERNMENT STRESS SHORTCOMINGS OF IT. THE OBJECTIVE OF ESTABLISHING A NEW CURRENCY WOULD BE TO BRING ALL ISRAELI CURRENCY BACK INTO THE OFFICIAL , THAT IS, TAXABLE, SYSTEM. HOWEVER, SINCE THE HOLDERS OF LARGE AMOUNTS OF UNTAXED OR QUOTE BLACK UNQUOTE MONEY, HAVE INVESTED IT IN EITHER LINKED BEARER BONDS OR HAVE CONVERTED IT INTO FOREIGN CURRENCY, A CURRENCY EXCHANGE SCHEME WOULD SERVE TO PENALIZE MAINLY SMALL TAX EVADERS WHO ACTUALLY HOLD CASH.

3. THE GOI ITSELF IS RESPONSIBLE FOR SOME OF THE INCREASED ANXIETY BECAUSE OF TIS ANNOUNCED INTENTION TO CONTINUE THE DEVALUATION OF THE ISRAELI POUND, WHICH HAS BEEN DEVALUED BY 67 PERCENT IN THE LAST TWELVE MONTHS. ADDITIONALLY, AN INTEGRAL PART OF LAST JULY'S INCOME TAX REFORM WAS A CRACK-DOWN ON TAX EVASION. THESE TWO ELEMENTS ARE PROBABLY THE MAIN CAUSES FOR THE SPECTACULAR DEPTHS TO WHICH THE ISRAELI POUND HAS FALLEN ON THE BLACK MARKET; THE RATE IS NOW OVER TEN ISRAELI POUNDS PER DOLLAR, COMPARED TO THE OFFICIAL RATE OF SEVEN PER DOLLAR FOR A DISPARITY OF ALMOST 50 PERCENT.

4. THE SITUATION HAS BECOME SUCH A CAUSE OF CONCERN THAT FINANCE MINISTER RABINOWITZ HELD A PRESS CONFERENCE NOV 3 IN WHICH HE REPORTEDLY ADMONISHED THE NEWS MEDIA NOT TO SCARE THE PUBLIC WITH RUMORS AND TO TAKE IT EASY. RABINOWITZ WAS QUOTED AS SAYING THERE WAS NO NEED FOR ANOTHER LARGE DEVALUATION BECAUSE THE ISRAELI POUND HAD BEEN DEVALUED BY TEN PERCENT ON SEPT 28 AND THE DOLLAR HAD DEPRECIATED BY THREE PERCENT IN THE INTERIM. THE MINISTER ALSO REJECTED PROPOSALS TO TAX INFLATIONARY GAINS FROM PROFITS ON INDEX-LINKED BONDS. HE SAID THAT THE TREASURY ESTIMATED A SEVEN TO 11 PERCENT REAL INCREASE IN EXPORTS IN 1976 WHICH WOULD HELP AMELIORATE THE OVER \$4 BILLION BALANCE OF PAYMENTS DEFICIT. HE ALSO REPORTEDLY POINTED OUT THAT OCTOBER'S TRADE FIGURES WERE PROMISING BECAUSE THEY SHOWED GENERAL EXPORTS HAD INCREASED NINE PERCENT, CONTRASTED TO ONLY ONE PERCENT FOR THE FIRST TEN MONTHS OF 1975.

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5. THE REACTION OF ISRAELI CONSUMER TO ALL OF THIS IS IMMINENTLY REASONABLE, FROM HIS POINT-OF-VIEW, BUT CRUCIAL TO THE GOVERNMENT'S ECONOMIC POLICY. IF THERE ARE RUMORS THAT SUBSIDIES ON BASIC COMMODITIES WILL BE LOWERED OR ELIMINATED, HE STOCKPILES OR HOARDS. IF THE CURRENCY IS TO BE DEVALUED AND PRICES INCREASED, HE BUYS, ON CREDIT IF POSSIBLE, PROLONGS PAYMENT ON HIS DEBTS, SEEKS SOME WAY TO TIE HIS SAVINGS TO A STRONGER CURRENCY, AND DELAYS CONVERTING ANY FOREIGN CURRENCY HE

MIGHT HAVE. THIS MEANS THAT THE GOVERNMENT'S POLICY OF TRYING TO REDUCE PRIVATE CONSUMPTION HAS LESS EFFECT THAN WOULD BE INDICATED BY THE MAGNITUDE OF THE MEASURES AND CREATES A SITUATION WHERE STRONGER MEASURES ARE NECESSARY. THIS, IN TURN, REINFORCES THE CONSUMER'S INCENTIVES TO BUY NOW AND PAY LATER. WHILE REASONABLE FROM THE INDIVIDUAL'S VIEWPOINT, THESE ACTIONS SPELL TROUBLE FOR GOVERNMENT EFFORTS TOWARD AUSTERITY. AN ATMOSPHERE IS CREATED WHERE REACTIONS ARE MAGNIFIED OUT OF PROPORTION (REF A).

6. THE BASIC UNDERLYING REASON FOR ISRAEL'S ECONOMIC ANXIETY IS THAT EVERYONE KNOWS THE NEXT FEW YEARS WILL BE DIFFICULT. THE GOI HAS ANNOUNCED ITS INTENTION TO CONTINUE FOR ANOTHER YEAR PRESENT POLICY OF NO REAL GROWTH ACCOMPANIED BY INCREASED EXPORTS AT THE COST OF CONSUMPTION (REF B). THE ONLY SERIOUS ALTERNATIVE ECONOMIC POLICY, FORMULATED BY THE OPPOSITION LIKUD, CALLS FOR EVEN GREATER RESTRAINT (REF C). HOWEVER, EVEN THOSE WHO ADVOCATE THE MOST STRINGENT POLICIES IN ORDER TO TURN THE ECONOMY IN THE DIRECTION OF LESS DEPENDENCE ON FOREIGN ASSISTANCE RECOGNIZE THAT SUCH MEASURES WOULD ONLY RESULT IN SMALL IMPROVEMENTS IN THE BALANCE OF PAYMENTS IN THE NEXT SEVERAL YEARS. MANY OBSERVERS BELIEVE THAT MORE STRINGENT MEASURES SHOULD NEVERTHELESS BE ADOPTED (1) TO ASSURE ISRAEL'S FRIENDS ABROAD THAT IT IS ITSELF DOING EVERYTHING POSSIBLE TO DEAL WITH ITS ECONOMIC PROBLEMS AND (2) TO CONVINCE ISRAELI PUBLIC THAT GOI IS ABLE AND DETERMINED TO MOVE ECONOMY IN RIGHT DIRECTION.
TOON

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, FINANCIAL STABILITY, ECONOMIC PROGRAMS, CURRENCY STABILITY, PRESS CONFERENCES, PUBLIC ATTITUDES
Control Number: n/a
Copy: SINGLE
Draft Date: 05 NOV 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975TELAV07018
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750385-0735
From: TEL AVIV
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19751174/aaaacope.tel
Line Count: 143
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION NEA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 75 TEL AVIV 6959, 75 TEL AVIV 6847, 75 TEL AVIV A-173
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 11 AUG 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <11 AUG 2003 by izenbei0>; APPROVED <01 DEC 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ISRAEL'S ECONOMIC ANXIETY
TAGS: EAID, EFIN, ECON, IS, (RABINOWITZ, YEHOASHUA)
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006